UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

In re Washington Mutual, Inc. Securities, Derivative & ERISA Litigation	Case No. 2:08-md-1919 MJP
IN RE WASHINGTON MUTUAL, INC. SECURITIES LITIGATION This Document Relates to: C09-664 MJP C09-816 MJP	ORDER GRANTING THE DIRECTOR DEFENDANTS' AND DELOITTE & TOUCHE LLP'S MOTIONS TO DISMISS

This matter comes before the Court on the Director Defendants'[1] and Deloitte & Touche LLP's ("Deloitte") motions to dismiss Plaintiffs' California state law claims against them. (Dkt. Nos. 447, 448.) Having reviewed the motions, Plaintiffs' responses (Dkt. Nos. 482, 483), the replies (Dkt. Nos. 494, 496), and all papers submitted in support thereof, and having heard oral argument on April 21, 2010, the Court GRANTS both motions to dismiss. The Court has reviewed Deloitte's request for judicial notice, and GRANTS the request.

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[1] The Director Defendants are Stephen Frank, Thomas Leppert, Phillip Matthews, Michael Murphy, William Reed, Jr., and Orin C. Smith. (Consolidated Amended Complaint ¶¶ 28-33.)

Background

A. Allegations[2]

Plaintiffs Lou Solton, Monterey County Treasurer, and the City of San Buenaventura allege three causes of action against the Director Defendants and Deloitte, among others. Plaintiffs allege the Director Defendants and Deloitte made both fraudulent and negligent misrepresentations in three Annual Reports (Forms 10-K) filed with the Securities and Exchange Commission ("SEC") and violated the California Corporations Code. These allegations largely mirror those asserted in the Securities Class Action complaint filed in the ongoing MDL action (No. 08-md-1919, No. 08-387 (lead case)).

Relevant to the pending motions, Plaintiffs allege Washington Mutual ("WaMu" or the "Company"), including the Director Defendants and WaMu's "long-time auditor" Deloitte, deceived Plaintiffs as to the level of risk assumed by the Company and its abandonment of "recognized underwriting standards used to evaluate both 'prime' mortgages and 'subprime' loans." (Consolidated Amended Complaint ("Complaint") ¶ 3.) WaMu "secretly minimized the effectiveness of WaMu's risk management group by relegating the group to a 'customer service' role and adopting policies designed to encourage loan volume over credit risk management." (Id. ¶ 5.) At the same time, WaMu pressured appraisers to inflate appraisals values, which permitted WaMu to originate loans with artificially low loan-to-value ("LTV") ratios. (Id. ¶ 6.) WaMu also failed to maintain, report, and periodically adjust its Allowance of Loan and Lease Losses in accord with generally accepted accounting principles ("GAAP")." (Id. ¶ 8.) For example, WaMu's Loan Performance Risk Model ("LPRM"), which was used to calculate the Allowance, "failed to take into account important credit risks. . . ." (Id.) As a result, WaMu "misstated its financial results by under-

[2] The following allegations are taken from the Consolidated Amended Complaint and are accepted as true solely for the purpose of deciding the pending motions. Nothing should be construed as acceptance of these allegations as proven fact.

provisioning the Allowance and reporting artificially inflated net income in each quarter during 2005-2007." (Id.)

The Director Defendants were integral to the function of the Company and signed WaMu's Annual Reports. (Compl. ¶ 338.) Each of the Director Defendants served on WaMu's Audit Committee and all but Defendant Leppert served on the Finance Committee. (Id. ¶¶ 28-33.) WaMu's Forms 10-K for 2006 and 2007 state "the Board of Directors, assisted by the Audit and Finance Committees on certain delegated matters, oversees the Company' monitoring and controlling of significant risk exposures, including the Company's policies governing risk management." (Id. ¶ 339.) WaMu's 2006 10-K stated that the Finance Committee "approved a set of credit risk concentration limits . . . that better enables credit risk management to proactively manage credit risk." (Id. ¶ 275.) On April 3, 2008, WaMu filed a Schedule 14A with the SEC stating that "our entire board are and have been actively engaged in formulating and overseeing management's implementation of risk management policies." (Id. ¶ 344.) Plaintiffs also detail the role and duties of these committees in overseeing risk and financial reporting at the Company. (Id. ¶¶ 339-43.)

Deloitte served as WaMu's auditor during the relevant time period, and issued "clean" audit opinions in WaMu's Annual Reports for 2005-2007 that "misrepresented the true financial condition of WaMu" and Deloitte's "compliance with professional standards of care." (Compl. ¶¶ 326, 315.) The audit opinions were not filed in compliance with generally accepted accounting standards ("GAAS"), despite the fact Deloitte was "intimately familiar with WaMu's business model, its employees, its products, and its increasing exposure by virtue of its loan practices." (Id. ¶¶ 326, 314.) Deloitte reviewed WaMu's internal controls, reviewed its risk exposure, real estate loan valuations, and loan practices, audited large transactions, and participated in drafting and reviewing WaMu's quarterly press releases. (Id.) Deloitte also "reviewed drafts of WaMu's filings with the SEC prior to filing" and "attended and made presentations at Board of Director meetings, where it discussed the

results of its examination of WaMu's financial statements." (Id. ¶ 314.) "Deloitte knew or recklessly disregarded the true financial condition and exposure of WaMu, the value of WaMu's loan 'assets,' the true credit risks, and WaMu's deteriorating financial condition, which contradicted the unqualified audit reports on WaMu's financial statements meant to be distributed to the market." (Id. ¶ 327.)

B. Judicial Notice

Deloitte asks the Court to take judicial notice of several documents the Court previously noticed in deciding motions to dismiss in the MDL. (See Dkt. No. 450 (citing Exhibits 1-5, 7, 9 to the Lutz Declaration).) The Court takes notice of these documents. Deloitte also requests judicial notice of three documents that contain auditing standards not previously noticed by the Court. (Lutz Decl. Exs. 6, 8, 10.) Plaintiffs do not oppose the request, and the Court takes notice of these documents. Deloitte also requests the Court take notice of two SEC filings that have not previously been noticed. (Lutz Decl. Exs. 11-12.) Plaintiffs refer to them in their complaint and the Court takes notice of them. The Court does not draw any inferences in favor of Defendants from these judicially-noticed facts. See McGuire v. Dendreon, No. 07-800MJP, 2008 WL 1791381, at *4 (W.D. Wash. Apr. 18, 2008).

Analysis

A. Standard

When dealing with allegations of fraud, Rule 9(b) imposes a heightened standard, requiring that "the circumstances constituting fraud or mistake . . . be stated with particularity." Fed. R. Civ. P. 9(b). Under Rule 9(b), a plaintiff must plead his claim with "particularized allegations of the circumstances constituting fraud," which should include "[t]he time, place, and content of an alleged misrepresentation" in addition to "the circumstances indicating falseness." In re GlenFed Sec. Litig., 42 F.3d 1541, 1547-48 (9th Cir. 1994) (emphasis omitted). "[C]onclusory allegations of fraud . . . punctuated by a

handful of neutral facts" are insufficient. Id. at 1548 (quotation omitted). Ultimately, "[t]he plaintiff must set forth what is false or misleading about a statement, and why it is false." Id. at 1548. The pleading must be "specific enough to give defendants notice of the particular misconduct . . . so that they can defend against the charge and not just deny that they have done anything wrong." Vess v. Ciba-Geigy Corp. USA, 317 F.3d 1097, 1106 (9th Cir. 2003) (internal quotation omitted). Rule 9(b) permits the plaintiff to plead intent and knowledge generally, but the plaintiff still has the obligation to "set forth facts from which an inference of scienter could be drawn." Cooper v. Pickett, 137 F.3d 616, 628 (9th Cir. 1997) (quoting GlenFed, 42 F.3d at 1546).

When a plaintiff "allege[s] a unified course of conduct and rel[ies] entirely on that course of conduct as the basis of the claim[,] . . . the claim is said to be 'grounded in fraud' or to 'sound in fraud,' and the pleading of that claim as a whole must satisfy the particularity requirement of Rule 9(b)." Vess, 317 F.3d at 1103. Here, Plaintiffs' negligent misrepresentation claims are based on the same course of conduct alleged to constitute fraud, and they are therefore subject to Rule 9(b). Id.; see also Meridian Project Sys., Inc. v. Hardin Constr. Co., LLC, 404 F. Supp. 2d 1214, 1219 (E.D. Cal. 2005) ("It is well settled in the Ninth Circuit that misrepresentation claims are a species of fraud, which must meet Rule 9(b)'s particularity requirement."); Neilson v. Union Bank of Cal., N.A., 290 F. Supp. 2d 1101, 1141 (C.D. Cal. 2003) (same).

B. Group Pleading

The Director Defendants argue Plaintiffs' fraud and negligent misrepresentation claims fail because Plaintiffs do not cite to any statements made by the Director Defendants. Plaintiffs respond they have satisfied the "group pleading doctrine," which permits them to sue the Director Defendants for statements contained in SEC filings they signed. Plaintiffs are correct.

Under the group pleading doctrine, there is a presumption that allegedly false and misleading group-published information is the collective action of officers and directors. In re GlenFed, Inc. Sec. Litig., 60 F.3d 591, 593 (9th Cir. 1995). "'Group-published information' is information contained in documents such as annual reports and press releases." In re Secure Computing Corp. Sec. Litig., 120 F. Supp. 2d 810, 821 (N.D. Cal. 2000). Under the group-pleading doctrine, Plaintiffs can attribute statements to individual defendants based on their positions, rather than pleading facts that show that a defendant actually made, authored, or communicated a statement. To do so, Plaintiffs must allege the defendants either "participated in the day-to-day corporate activities, or had a special relationship with the corporation, such as participation in preparing or communicating group information at particular times." In re GlenFed, 60 F.3d at 593.

Plaintiffs have alleged sufficient facts satisfying the "group pleading doctrine." Plaintiffs explain the Director Defendants' roles on the Audit or Finance Committees and their duty, "power[,] and authority to control the statements made" in SEC filings they signed. (Compl. ¶¶ 28-34, 338-39.) More importantly, Plaintiffs allege the Director Defendants participated in setting credit risk limits and touted the Director Defendants' role in both "formulating and overseeing management's implementation of risk management policies." (Compl. ¶¶ 275, 344.) Plaintiffs thus plead more than the Director Defendants' roles on the committees, which alone would be insufficient. See In re GlenFed, 60 F.3d at 593 (committee membership alone is insufficient to satisfy the doctrine); Schwartz v. KPMG LLP, 476 F.3d 756, 765 (9th Cir. 2007) (suggesting that "detailed allegations of an agreement between the defendants and the various roles played in the alleged conspiracy" would satisfy the doctrine). The Court DENIES the Director Defendants' motion on this issue.

C. Fraudulent Misrepresentation

To sustain their fraudulent misrepresentation claims, Plaintiffs must allege in accordance with Rule 9(b) that (1) Defendants made misrepresentations or omissions; (2)

Defendants knew of the falsity (scienter); (3) Defendants had an intent to defraud or to induce reliance; (4) Plaintiffs justifiably relied on Defendants' statements or omissions; and (5) Plaintiffs suffered damages. Small v. Fritz Cos., Inc., 30 Cal. 4th 167, 173-74 (2003).

Deloitte and the Director Defendants argue that Plaintiffs' fraudulent misrepresentation claims fail to allege sufficiently particularized facts as to each element to survive dismissal. (Dkt. Nos. 447 at 12-19, 448 at 13-21.) While Plaintiffs have alleged sufficient facts as to falsity, scienter, and intent, they have not adequately alleged facts to support the element of justifiable reliance.

Plaintiffs' allegations of misrepresentation attributable to Deloitte and the Director Defendants are limited to the Annual Reports filed with the SEC (Forms 10-K). Deloitte allegedly issued its audit opinions in the Forms 10-K, and the Director Defendants signed the Forms 10-K. The Court's analysis is limited to statements made in three Forms 10-K (2005-2007).

1. Falsity

Deloitte argues the complaint fails to identify the falsity of Deloitte's audit certifications. The Court has already sustained under Rule 9(b) the falsity of representations made in the 2005 and 2006 Forms 10-K regarding WaMu's compliance with GAAP and the soundness of its risk management, appraisals, underwriting, financial statements, and internal controls. (Dkt. No. 381 at 10-28.) The allegations in the present complaint are sufficient to show the falsity of Deloitte's certification that WaMu was in compliance with GAAP. (See Compl. ¶¶ 105-06, 116, 130, 163, 193, 211, 234, 244, 245, 274, 275, 276.) However, the Court has not considered the falsity of Deloitte's certification in the 2007 Annual Report.

Plaintiffs allege Deloitte violated GAAS by providing a clean audit opinion in WaMu's Annual Report for 2007 when it could not have legitimately done so. (Compl. ¶ 315.) The complaint states that WaMu's 2007 Annual Report continued to conceal the Company's "improper lending, accounting practices and deficient risk management practices

as well as the true extent of the Company's loss exposure." (Id. ¶ 294.) The complaint alleges with detail that WaMu failed to provision properly its Allowance, maintain proper risk management, or keep disciplined lending and underwriting guidelines throughout 2007. (See, e.g., id. ¶¶ 252-64.) WaMu allegedly violated GAAP by not increasing its Allowance in a "manner commensurate with the decreasing credit quality of [its] home mortgage products." (Id. ¶ 253.) In spite of these deficiencies, "Deloitte certified that its audits of WaMu's books were done in accordance with GAAP and GAAS. They were not." (Id. ¶ 337.) These allegations are sufficient to show the falsity of Deloitte's certification in the 2007 Form 10-K. The Director Defendants do not challenge the falsity of the alleged misrepresentations attributable to them. The Court finds these to be sufficiently alleged.

2. Scienter and Intent

The Director Defendants argue there are insufficient facts showing their scienter. Deloitte makes the same argument and adds that the allegations as to intent are also insufficient. The allegations in the complaint survive dismissal.

Plaintiffs must set forth sufficient general facts from which an inference of scienter and intent to induce reliance can be drawn. As to Deloitte, to satisfy scienter and intent, Plaintiffs must allege Deloitte "has no belief in the truth of the statement[s], and makes it recklessly, without knowing whether it is true or false. . . ." Bily v. Arthur Young & Co., 3 Cal. 4th 401, 415 (1992). Plaintiffs need not show "the auditor's actual knowledge of the false or baseless character of its opinion." Id. As to both Deloitte and the Director Defendants, Plaintiffs may allege generally scienter and an intent to defraud. Fed. R. Civ. P. 9(b). Plaintiffs argue they may satisfy scienter "simply by saying that scienter existed." (Dkt. No. 483 at 19 (quoting In re GlenFed Sec. Litig., 42 F.3d 1541, 1547 (9th Cir. 1994)).) Even though scienter may be established generally, such a conclusory allegation would be insufficient under Rule 9(b) particularly since similar allegations would fail Rule 8(a). See Bell Atl. Corp. v. Twombly, 550 U.S. 544, 555 (2007) (Rule 8(a) requires plaintiffs to plead

"more than labels and conclusions, and a formulaic recitation of the elements of a cause of action . . ."); Ashcroft v. Iqbal, 129 S. Ct. 1937, 1949 (2009) (same).

The allegations suffice to show the Director Defendants' scienter as to statements regarding WaMu's risk management and credit risk. Two SEC filings affirmatively state the Director Defendants were knowledgeable of and participated in the oversight and development of risk management and credit risk guidelines. (Compl. ¶¶ 275, 344.) Plaintiffs also point to the Director Defendants' knowledge of WaMu's risk management through their membership on the Finance and Audit Committees. (Id. ¶¶ 28-33, 275, 338-44.) Plaintiffs allege, too, that William Longrake, a former senior WaMu executive repeatedly warned the Board of Directors that the housing market was becoming too risky and that WaMu should limit its exposure. (Id. ¶ 184.) These allegations taken together are sufficient as to scienter with regard to statements in the Forms 10-K related to risk management and credit risk. Plaintiffs fail to satisfy scienter related to other areas of business in which WaMu was active. Plaintiffs rely only on the Director Defendant's committee positions and responsibilities, which is insufficient. See In re GlenFed, 60 F.3d at 593 (allegations are insufficient against outside directors when they describe only committee membership and responsibilities).

Plaintiffs' allegations of scienter and intent to defraud against Deloitte are also adequate. Plaintiffs allege Deloitte was "intimately familiar with WaMu's business model, it employees, its products, and its increasing exposure by virtue of its loan practices." (Compl. ¶ 314.) Plaintiffs state that Deloitte reviewed WaMu's internal controls, "paying specific attention to loan practice, real estate loan valuations and risk exposure." (Id.) Deloitte allegedly participated in drafting quarterly press releases, reviewing drafts of WaMu's SEC filings, and making presentation to the Board of Director and Committee meetings, where "it discussed the results of its examination of WaMu's financial statements." (Id.) Deloitte is squarely alleged to have been aware of WaMu's risky real-estate practices, inadequate Allowance, and its weak internal controls and risk management. Taken together, these

allegations suffice to show that the "clean" audit reports Deloitte issued were done without belief in their truth or that Deloitte acted recklessly. See Bily, 3 Cal. 4th at 415. The allegations satisfy both scienter and intent.

Deloitte attacks the complaint's "must have known" allegations by relying on three cases decided under the PSLRA's heightened pleading standard. (Dkt. No. 448 at 20.) Deloitte argues that courts routinely reject allegations similar to Plaintiffs', where the auditor is alleged to be familiar with the company and had access to the business' internal information. (Id.) The proposition is convenient for Deloitte, but inapplicable to Plaintiffs' complaint for the simple reason that Plaintiffs need not allege facts that strongly compel an inference of fraudulent intent or scienter. See Fed. R. Civ. P. 9(b). Plaintiffs have satisfied their burden under Bily and Rule 9(b). The Court DENIES both Defendants' motion on this issue.

3. Reliance

The Director Defendants and Deloitte attack the allegations of justifiable reliance. Defendants correctly point out that Plaintiffs' allegations of reliance are inadequate.

A cause of action for "deceit based on a misrepresentation" requires the plaintiff to allege that "he or she actually relied on the misrepresentation." Mirkin v. Wasserman, 5 Cal. 4th 1082, 1088 (1993). The plaintiff must allege "specific reliance on the defendants' representations: for example, that if the plaintiff had read a truthful account of the corporation's financial status the plaintiff would have sold the stock, how many shares the plaintiff would have sold, and when the sale would have taken place." Small 30 Cal. 4th at 184. "The plaintiff must allege actions, as distinguished from unspoken and unrecorded thoughts and decisions, that would indicate that the plaintiff actually relied on the misrepresentations." Id.

Plaintiffs rely on two allegations to show the adequacy of their reliance with regard to the fraudulent misrepresentation claim:

> 354. . . . If Plaintiffs had known the true facts, they would not have invested in or continued to hold the WaMu notes, and would have divested of them immediately.
>
> 355. Plaintiff reasonably relied on these representations, including Deloitte's unqualified audit reports, in investing in and continuing to hold WaMu securities and their reliance was justified since the Defendants had exclusive knowledge of the true facts.

(Compl. ¶¶ 354-55.) These generic allegations of reliance do not satisfy the particularity standards of Rule 9(b). Plaintiffs only suggest that they read the Forms 10-K and Deloitte's certifications, without expressly alleging which documents they read, when the read them or how they impacted their decision to purchase or retain WaMu debt securities. Plaintiffs paint with a broad brush and do not meet the particularity requirements of Rule 9(b).

Plaintiffs argue that they have adequately alleged forebearance. (See Dkt. Nos. 482 at 20-21, 483 at 16-18 (citing Mirkin, 5 Cal. 4th at 1093); Compl. ¶ 354.) However, Plaintiffs must still allege with particularity facts showing that "had [they] read a truthful account of the corporation's financial status [they] would have sold the stock, how many shares [they] would have sold, and when the sale would have taken place." Small, 30 Cal. 4th at 184. Here, Plaintiff's allegations are conclusory and without sufficient detail. The Court GRANTS the motion on this issue and DISMISSES Plaintiffs' fraudulent misrepresentation claims against the Director Defendants and Deloitte.

D. Negligent Misrepresentation

1. Deloitte

Deloitte argues that Plaintiffs cannot pursue their negligent misrepresentation claims because Plaintiffs are not of the class of persons to whom Deloitte owed a duty. Deloitte is correct.

Under California law, Deloitte, as an auditor, has limited liability for negligent misrepresentations. Generally, an auditor is only liable to a class of persons who are the intended beneficiaries of the auditor's opinion. See Bily, 3 Cal. 4th at 410. An auditor who

performs an annual audit is not liable to all investors, except in limited circumstances. Id. at 393 (quotation omitted). One court applying Bily concluded that an auditor who does an annual opinion for no special particular purpose has no duty to third parties. Indus. Indem. Co. v. Touche Ross & Co., 13 Cal. App. 4th, 1087, 1094 (1993). However, when an auditor prepares a transaction-specific audit statement or is informed of the intended audience distinct from the general investing public, liability can attach. See Bily, 3 Cal. 4th at 393-94, 413-14.

Plaintiffs have not specified why Deloitte's annual audits of WaMu's financials fall outside of the bar set forth in Bily. Nothing in the complaint sets Plaintiffs apart from the general investing public. Plaintiffs have only alleged Deloitte made statements in annual audits that were part of the Forms 10-K. They have not shown any other allegations that Deloitte knew their audits would be relied on by Plaintiffs or any class other than the general public. Plaintiffs' reliance on Bily's statement that auditors are presumed to know that persons rely on their reports is unpersuasive. (Dkt. No. 482 at 21.) The section Plaintiffs cite in Bily is dicta and conflicts with the case's holding on this narrow issue. Plaintiffs' negligent misrepresentation claim is fatally flawed as to Deloitte.

Plaintiffs try to avoid the bar on auditor liability set out in Bily by relying on a case that is factually distinct and of little support. See Nutmeg Secs., Ltd. v. McGladrey & Pullen, 92 Cal. App. 4th 1435, 1444 (2001); (Dkt. No. 482 at 22.) Plaintiffs rely heavily on one statement in Nutmeg that an auditor may be liable "for negligent misrepresentation to those third parties who reasonably and foreseeably relied on the financial records, the audit, or both." Nutmeg, 92 Cal. App. 4th at 1444 (citing Bily, 3 Cal. 4th at 389-92). In Nutmeg, the court held that the plaintiffs had met this standard by alleging the auditor had participating in preparing the company's "most significant financial records" and had manipulated them after being threatened by the company to do so. Nutmeg, 92 Cal. App. 4th at 1443. Here, however, Deloitte is not alleged to have fabricated any financial reports. Rather, it only prepared auditor reports and reviewed quarterly information. Deloitte is not alleged to have

participated in manipulating or influencing the financial statements. Nutmeg is inapposite and of no support to Plaintiffs. The Court GRANTS Deloitte's motion and DSIMISSES the negligent misrepresentation claim as to Deloitte.

2. Merits

On the merits, Plaintiffs' negligent misrepresentation claims against the Director Defendants and Deloitte are flawed for the same reason as the fraudulent misrepresentation claim: the allegations of reliance are deficient. See Cadlo v. Owens-Illinois, Inc., 125 Cal. App. 4th 513, 519 (2004) (stating that the requirements for a negligent misrepresentation claim mirror those of a fraudulent misrepresentation claim except Plaintiff need not allege scienter). Plaintiffs' allegations as to reliance lack the particularity required to survive dismissal under Rule 9(b). Defendants' motions are GRANTED and the claims DISMISSED.

E. Aiding and Abetting

Plaintiffs contend in their response briefs that the Director Defendants and Deloitte are liable for fraudulent and negligent misrepresentation as aiders and abettors to the primary violations committed by other defendants. (Dkt. Nos. 482 at 23-24, 483 at 23-25.) This argument is without merit.

Plaintiffs have not pleaded a separate claim for aiding and abetting. This alone is fatal. The merits of such a claim are also inadequately supported by the pleadings. To satisfy a claim of aiding and abetting of an intentional tort (fraudulent misrepresentation), Plaintiffs must allege the Director Defendants and Deloitte knew "the other[defendants'] conduct constitute[d] a breach of duty and [gave] substantial assistance or encouragement to the other to so act or . . . [gave] substantial assistance to the other in accomplishing a tortious result and the person's own conduct, separately considered, constitutes a breach of duty to the third person." See Saunders v. Superior Court, 27 Cal. App. 4th 832, 846 (1994). Plaintiffs must allege Deloitte and the Director Defendants had actual knowledge of the primary violation. Howard v. Superior Court, 2 Cal. App. 4th 745, 749 (1992). Plaintiffs have not so alleged,

nor have they alleged how these defendants provided substantial encouragement or assistance. See Neilson v. Union Bank of Cal., N.A., 290 F. Supp. 2d 1101, 1119-1120 (C.D. Cal. 2003) (finding allegations sufficient where the complaint specifically alleged the defendants knew another was committing fraud and actively participated in the fraud). The Court GRANTS the motions to dismiss and DISMISSES this claim.

F. California Corporations Code

Defendants move to dismiss Plaintiffs' state law claims brought pursuant to California Corporation Code § 25400, et seq. (Dkt. No. 447.) In response, Plaintiffs clarify for the first time that they are pursuing claims against the Director Defendants pursuant to California Corporations Code § 25504 and against Deloitte pursuant to California Corporations Code § 25403(b) and § 25504.1. (Dkt. Nos. 482 at 24-26, 483 at 25-27.)

Under California Corporations Code § 25504 and § 25504.1, Deloitte and the Director Defendants can be liable only if Plaintiffs have allege a primary violation of California Corporations Code § 25401. To do so, Plaintiffs must allege that one of the defendants was the seller of the securities and plaintiff must be in privity with the seller. See Lubin v. Sybedon Corp., 688 F. Supp. 1425, 1453 (S.D. Cal. 1988); S.E.C. v. Seaboard Corp., 677 F.2d 1289, 1296 (9th Cir. 1982). Plaintiffs have not alleged who they purchased the securities from or whether the seller is one of the Defendants. At oral argument Plaintiffs conceded that they likely purchased them from a third-party. The allegations in the complaint are therefore inadequate and the claims under California Corporations Code §§ 25504 and 25504.1 are defective. The Court GRANTS Defendants' motions on this claim.

Deloitte argues further that there is not private right of action under § 25403(b) and Plaintiffs attempt to pursue this cause of action is fatally flawed. See Apollo Capital Fund, LLC v. Roth Capital Partners, LLC, 158 Cal. App. 4th 226, 255 (2007) (holding that no private right of action under § 25403 exists). Deloitte is correct. The Court GRANTS

Deloitte's motion and DISMISSES the California Corporations Code claims against both Defendants.

Conclusion

Plaintiffs have not adequately pleaded viable fraudulent and negligent misrepresentation claims against Deloitte and the Director Defendants. Plaintiffs' threadbare allegations as to reliance are inadequate to proceed on either claim. The complaint does not alleged sufficient facts to sustain a negligent misrepresentation claim against Deloitte given the rule set forth in Bily. Plaintiffs' aiding and abetting claim is no substitute. The fatal defects in Plaintiffs' California Corporations Code warrant dismissal. The Court GRANTS Deloitte's and the Director Defendants' motions to dismiss and DISMISSES the claims against them. The Court GRANTS Deloitte's request for judicial notice.

The Clerk is directed to send a copy of this order to all counsel of record.

DATED this 28th day of April, 2010.

Marsha J. Pechman
United States District Judge